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SUBJECT: THE 2008 U.S.-PAKISTAN ECONOMIC DIALOGUE

Classified by Anne W. Patterson, reasons 1.4 (b) and (d)

¶1. (C) Summary: The U.S.-Pakistan Economic Dialogue was held in Islamabad on August 11, co-chaired by Assistant Secretary of State for Economic, Energy, and Business Affairs Dan Sullivan and Pakistani Minister of Finance Syed Naveed Qamar. A topic of particular concern was the current state of the economy, and the GOP's efforts to manage their budget deficit and rapidly decreasing foreign exchange reserves. The GOP asked for U.S. assistance in seeking external financing. The Labor Secretary said that the GOP was making progress towards resuming surprise labor inspections. Both sides agreed that Bilateral Investment Treaty (BIT) experts should reconvene very soon with a goal of completing negotiations by year end. On terrorism financing, the GOP said it was committed to the 1267 process but felt that it had a few deficiencies. A broad range of other topics was covered, including macroeconomic policy, BIT, intellectual property rights (IPR), energy, agriculture, terrorism financing, Reconstruction Opportunity Zones (ROZ), foreign assistance and Federally Administered Tribal Areas (FATA) development, regional cooperation and transit trade, and private sector cooperation. The GOP also pitched a proposal for a new scholarship program.

¶2. (C) U.S. participants included Ambassador Anne Patterson, Acting U.S. Trade Representative for South Asia Claudio Lilienfeld, Treasury Deputy Assistant Secretary Bob Dohner, Linda Droker from the U.S. Department of Commerce, USAID Senior Deputy Assistant Administrator for Asia Mark Ward, and U.S. Embassy EconOffs. Ministry of Finance Secretary Farrakh Qayyum and Advisor to the Prime Minister on Finance and Economic Affairs Rabbani Khar led the Pakistani delegation in multiple sessions in which Finance Minister Qamar was not present. Government of Pakistan (GOP) participation included Secretaries from the Ministries of Finance, Commerce, Agriculture, Labor and Water & Power, as well as representatives from the Ministry of Foreign Affairs, Ministry of Interior, Higher Education Commission, State Bank of Pakistan, Intellectual Property Organization, Board of Investment and Federally Administered Tribal Areas Secretariat. End summary.

OPENING REMARKS

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¶3. (C) Pakistani Finance Minister Syed Naveed Qamar opened the 2008 U.S.-Pakistan Economic Dialogue by thanking the United States for its long history of support and assistance. Recognizing that Pakistan is currently facing multiple economic challenges, Qamar emphasized that additional U.S. assistance programs would help Pakistan through its current economic troubles. Assistant Secretary Sullivan reiterated

the USG's broad commitment to Pakistan and expressed the U.S. desire to strengthen business-to-business and people-to-people contacts between the two nations. The Assistant Secretary described the 2008 Economic Dialogue as the most recent step in a series of high-level meetings between the two governments, including Prime Minister Gilani's July visit to Washington.

MACROECONOMIC POLICY

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¶4. (SBU) During the macroeconomic section, Assistant Secretary Sullivan and DAS Dohner noted U.S. concern over increasing signs of weakness in the Pakistani economy and stressed that additional assistance from international financial institutions could be done only in conjunction with GOP monetary and fiscal reforms, such as ceasing to finance the fiscal deficit through the central bank, expanding the tax base, and privatizing more rapidly. DAS Dohner stressed the importance of the GOP meeting the 4.7 percent of GDP fiscal deficit target, but noted that hitting this target would take significant effort on the part of the GOP. When asked about contingencies should the budget target not be met and the status of foreign reserves, Finance Minister Qamar replied that "all measures" including gas rationing "are in the cards." Regarding reserves, he said they continue to deplete "at a fairly rapid rate."

¶5. (SBU) The Prime Minister's Special Assistant for Finance and Economic Affairs Hina Rabbani Khar and Finance Minister Qamar noted there were indeed structural deficiencies in the economy that precipitated the crisis, but that part of Pakistan's problems were the result of exogenous factors, such as rapid increases in world oil

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and fuel prices. They stressed the GOP had begun to correct structural deficiencies with "politically difficult" measures such as eliminating petroleum subsidies by year-end, putting in place targeted subsidies in place of broad economic subsidies, increasing the tax base, mandating net zero borrowing from the central bank on a quarterly basis, and increasing the pace of privatization. Finance Minister Qamar (who also serves as the Minister of Privatization) added that September will see a "flurry of activity" when new privatization projects are announced including a gas field. Ms. Khar noted the GOP was undertaking a program of stringent fiscal restraint, including steps to eliminate fuel and electricity subsidies.

¶6. (SBU) Ms. Khar described Pakistan's current economic situation as a short- to medium-term challenge and said that Pakistan had good long-term growth potential. Both Ms. Khar and Finance Minister Qamar asked for U.S. assistance in seeking additional external financing from international financial institutions.

LABOR

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¶7. (SBU) Secretary Malik Asif Hayat of the Ministry of Labor opened the labor portion of the Economic Dialogue by highlighting the steps the GOP has taken to guarantee core labor rights and combat child and bonded labor. Hayat emphasized that the GOP has ratified all eight core International Labor Organization (ILO) conventions, highlighted that Pakistan was the second country in South Asia to do so. He also stated that Pakistan has instituted a national bonded labor policy and is in the process of combining Pakistan's 74 separate pieces of labor legislation into five broad bills. Hayat claimed the GOP would strengthen oversight of the informal sector and institute new labor protection and labor inspections policies.

¶8. (SBU) Turning to nationwide labor inspections, heavily regulated since 2003, Secretary Hayat reported that government and industry leaders recently met in Sialkot, Punjab to resolve outstanding issues and pave the way for the resumption of surprise labor inspections. Hayat recognized that labor inspections have been inadequate in the past but claimed that both the federal and provincial governments supported a timely resumption of inspections. Assistant Secretary Sullivan highlighted the importance the U.S. places on labor rights and conditions, particularly in trade relationships. He stressed that the U.S. was looking for labor inspections to be resumed quickly

and continued to press for labor rights to be guaranteed for all Pakistani workers, including those in Export Processing Zones (EPZs) and other industries covered under the Emergency Services Maintenance Act (ESMA).

BREAK OUT SESSION: BILATERAL INVESTMENT TREATY (BIT)

19. (C) The BIT break-out session, which lasted over two hours, was productive and set a positive tone for possible resumption of negotiations. The two sides outlined our mutual understanding of where things left off in March 2006, i.e., the five central, unresolved issues. The USG sent strong signals that if negotiations were to resume, we should focus on the five unresolved issues alone and not address matters raised subsequent to our last negotiating round in 2006. The Pakistanis signaled they would be amenable to picking up with these five issues but also may want to address the "shared understanding" as well as what they characterized as "loose ends" or "cross-cutting issues."

110. (C) The USG noted that we provided the 2006 "shared understanding" to Pakistan before President Bush's trip, in hopes of persuading Pakistan to sign the BIT during the President's visit. We said we hoped that our discussion of the five remaining issues during any future negotiations would be sufficient to satisfy GOP concerns and that if the GOP was still going to insist on a shared understanding, we would have to consult with our interagency before providing a response.

111. (C) Notwithstanding that we had not yet established a solid starting point, the GOP expressed the desire to reconvene negotiations, preferably in Islamabad so as to allow their stakeholder agencies to take a more active role. They promised to

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pass the 2006 negotiated text to these agencies, most of whom were not present at the meeting. GOP Finance Secretary Farrukh Qayyum joined for a few minutes during the session, emphasizing that he hoped that talks would not again be suspended and appealed for "renewed sensitivity" from each side.

112. (C) The tone of the breakout session was positive and equally good sidebars continued throughout the day. In our Joint Communique, we noted that the United States and Pakistan have a strong interest in resuming BIT negotiations and that our investment experts should meet as soon as possible to do so. The favorable initial working relationship and rapport that was forged during this breakout session should facilitate progress going forward.

INTELLECTUAL PROPERTY RIGHTS

113. (SBU) Finance Secretary Farrukh Qayyum opined that Pakistan's IPR laws were fragmented prior to 2005. Since that time, the GOP has taken multiple steps to bring Pakistan in line with international IPR norms. Recognizing that challenges still remain, Secretary Qayyum reported that the GOP's midterm goal is to strengthen enforcement capacity. Acting Assistant USTR for South Asia Claudio Lilienfeld pointed out that the U.S. still has concerns over IPR legislation, highlighting U.S. displeasure over the lack of data protection legislation, despite previous GOP pledges to quickly enact relevant legislation. Director Muhammad Arshad Khan of the Intellectual Property Organization (IPO) reported that legislation was currently with the Ministry of Health but stalled due to disagreements of data protection versus data exclusivity. U.S. participants singled out data protection and the protection of book publishing copyrights for future discussion.

ENERGY

114. (C) The session opened with an overview by the GOP of the energy situation in Pakistan. Noting that only ten percent of the sector is privatized, Muhammad Ismail Qureshi, Secretary of Water and Power remarked that privatization is expected to be increased to 60 percent over the next ten years and that a 40 percent increase in prices has

recently been passed to the public. Qureshi also vaguely highlighted other steps which the GOP is pursuing such as a new strategy to exploit indigenous resources in which the private sector will have a key role, passage of measures to allow electricity prices to fluctuate with market demands, as well as the development of a price strategy for the FATA to recover the full cost of electricity versus the current 98 percent loss. Stating that the GOP wants to add 16,000 megawatts by 2015 with USD 30 billion of investment, Qureshi noted this was approximately USD 3 billion per year, with 2 billion from the private sector and 1 billion from the public sector. He said Pakistan is planning road shows in the U.S. and Southeast Asia to secure these investments, with emphasis on coal and hydro-power development. Qureshi noted that the GOP is in need of experts on legal issues and capacity building involved in Thar coal development and that all parties are very interested in re-energizing the bilateral energy dialogue with the U.S.

¶15. (C) Assistant Secretary Sullivan said that everyone is facing energy challenges. He said that the BIT would boost investor confidence to bring in funding from the private sector for large scale projects. On the Iran pipeline, Sullivan noted that the U.S. does not support investment with Iran and also questioned whether the GOP could ensure that Iran is a reliable supplier. Sullivan also pointed out that the Siemens Westinghouse dispute, which has been in the judicial process for 10 years, does not build confidence with foreign investors who may be looking at potential opportunities in Pakistan. He emphasized the importance of arbitration moving quickly and that it was important to clear up the issue and put a transparent regime in place to avoid similar drawn-out disputes in the future. He also added the need to resolve late payments to Chevron, whose country manager the day before briefed the delegation that the company may leave Pakistan unless the issue is resolved. Noting that the U.S. is willing to fund a comprehensive geological mapping survey which could be very beneficial for the domestic energy sector, Sullivan asked the GOP to move forward with approval of the U.S. Geological Survey offer. A/S Sullivan also pointed out that he is

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the U.S. co-chair on the International Energy Association board and was willing to reach out to them for expertise if the GOP is interested.

AGRICULTURAL COOPERATION

¶16. (SBU) Finance Minister Qamar described increasing agricultural production as low hanging fruit, pledging that agricultural development will be the "main thrust of economic growth in the short term" as the income stays in the rural areas, which serves to alleviate poverty. He advocated strengthening the U.S.-Pakistan agricultural relationship. Qamar reported that water utilization remains a constraint for increased agricultural capacity; 60 percent of Pakistan's irrigation water never reaches crops due to inadequate irrigation systems and technology. Due to water constraints that prevent more planting, Secretary Muhammad Zia-ur-Rehman of the Ministry of Agriculture opined that the integration of genetically modified seeds is critical to increasing agricultural productivity. He requested enhanced U.S.-Pakistan collaboration on biotechnology research, cooperative biosecurity training and assistance in improving Pakistan agricultural value chains, particularly the use of cold storage and cool chain technologies and methods. Finance Secretary Qayyum also discussed more access to U.S. markets, noting their twelve year effort to ship mangoes to the U.S. The Agricultural Counselor replied that once the Cobalt 60 arrives and the irradiation facility is operating, USDA will restart the mango pre-shipment protocol. Also discussed were the ongoing negotiations to resolve differences over wheat import permit conditions so that U.S. commercial and food assistance wheat shipments to Pakistan could resume.

BREAK OUT SESSION: ELIMINATING TERRORISM FINANCE NETWORKS

¶17. (C) Treasury Deputy Assistant Secretary Bob Dohner represented the U.S. in a break out session on eliminating terrorism finance networks. While Pakistan's anti-money laundering legislation and

bulk cash interdiction programs were discussed, the majority of the breakout session focused on the UN 1267 committee and Pakistan's use of the People's Republic of China to block listings that reference Pakistan. Ministry of Foreign Affairs (MFA) representatives including UN Director Ahmed Farooq reported that while Pakistan remains "fully committed" to the 1267 process, the GOP believes that the process has "several deficiencies." Federal Investigation Agency (FIA) Commandant Khalid Qureshi claimed that Pakistan's opposition to 1267 listings that mention Pakistan or Pakistani nationals was a domestic issue, claiming that evidence submitted to justify 1267 listings would not hold up in a court of law. Qureshi reported that the GOP was reluctant to support such listings for fear that once the GOP froze assets of 1267 listed entities, the government would be brought to court over the action. MFA and FIA representatives requested the U.S. share more intelligence on the individuals and entities in question. When asked whether Pakistan would prosecute if evidence were provided, Finance Secretary Qayyum replied that "higher levels" would have to decide.

¶18. (C) Ahmed Farooq conceded that Pakistan's image was a motivation in blocking the listings, also reporting that supporting such listings "creates difficulties" for Pakistan. DAS Dohner responded that 1267 designations are not arbitrary and urged the GOP to ask the PRC to remove its holds on the listings in question. The breakout session concluded with both sides failing to come to an agreement on the issue.

¶19. (C) State Bank of Pakistan Executive Director Jameel Ahmed reported that the Anti-Money Laundering Ordinance was still valid, the GOP planned to amend the legislation, taking into consideration recommendations put forth by Financial Action Task Force (FATF) members. The Ministry of Finance currently has the draft legislation and is reviewing the legality of the changes but plans to submit the bill to the Federal Cabinet for approval. No timeline was provided. The Financial Monitoring Unit (FMU) is reportedly functioning and submitting information of suspicious transactions to the FIA, Anti Narcotics Force (ANF) and National Accountability Bureau (NAB). Ahmed claimed that legislation aimed at interdicting cash smugglers was currently under review and being "hotly debated" by various GOP

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agencies.

GOP SCHOLARSHIP PROPOSAL

¶20. (SBU) The GOP also presented a scholarship proposal for U.S. consideration. Noting that the Higher Education Commission (HEC) has seen the number of degrees conferred triple as well as a significant increase of money (USD 2 billion) into the sector, the GOP requested U.S. support to expand the "domestic brain pool for the future benefit of Pakistan." Stating that they would like to see fields of expertise tailored to the needs of the country, the GOP noted that 100 million Pakistanis are under the age of 25, so the need is great for higher education but currently only one in six high school graduates goes on to higher education. To provide more opportunities, the HEC proposed awarding 10,000 scholarships over five years. Last year, 1,000 individuals were sent abroad, primarily in Europe. The details of the program and specific areas of concentration remain to be worked out. Last year there were 100 Fulbright scholars and they would like to see this expanded to 1,000. A/S Sullivan noted that this concept could enhance long-term economic growth with graduates bringing back knowledge economy skills. He asked the Pakistani delegation to revise the proposal to include joint funding possibilities at which point he would share with the U.S. interagency.

RECONSTRUCTION OPPORTUNITY ZONES

¶21. (C) Commerce Minister Shah said that his ministry would take the lead on Reconstruction Opportunity Zones (ROZ) for the GOP. He said that Pakistan would still like to see all textile products included in the list of products since this sector is the largest employment generator. He was concerned that currently only 50 percent of textile production is currently included. He said that the issue has

been discussed with the Sarhad Development Authority and the Northwest Frontier Province (NWFP) Industrial Development Authority. The Finance Secretary pointed out that they have seen a lack of interest in ROZ's in the press and urged the U.S. to provide reassurance and more visibility on the subject.

¶22. (C) A/S Sullivan noted that work is proceeding to promote the bill and September is the targeted timeframe for passage of the bill. He also said that we have worked to develop as broad as possible geographic territory for eligibility and expansive product lists, but full coverage for textiles was not possible given U.S. domestic concerns. A/S Sullivan said that the next steps on ROZ's were to internationalize the concept by approaching Japan, Canada and others to offer ROZ-like trade benefits, informing traditional and Pakistani investors on how to do business in the ROZs, addressing labor issues and prioritizing ROZ locations. For geographic areas not included in ROZs, A/S Sullivan recommended outreach to ensure businesses in those areas were taking full advantage of General System of Preferences (GSP) benefits.

¶23. (C) The Secretary of Commerce responded that labor issues would not be a problem, he expected that there would be collective bargaining for Export Processing Zones (EPZs). Linda Droker from Department of Commerce said that EPZ rules need to be applied. A/USTR Lilienfeld said that a visit in September would be effective to help push the legislation on Capitol Hill.

FOREIGN ASSISTANCE AND FATA DEVELOPMENT

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¶24. (C) Ms. Hina Rabbani Khar, Economic Advisor to the Prime Minister, stated that they wanted more input into USAID projects in the FATA. Mark Ward, Senior Deputy Assistant Administrator for Asia, noted that USAID continues to work closely with the FATA Secretariat and other local stakeholders to ensure decisions were made locally. USAID agreed to support the FATA Secretariat in improving communication with stakeholders in the capital but stressed the need for quick project implementation and visible progress, noting that delays can also be visible. A/S Sullivan noted the importance of country led efforts, accountability and USG efforts at improved coordination of G8 donor activities. He also noted existing projects in the FATA that may be linked to implementation of Reconstruction

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Opportunity Zones. Khar agreed with the need for greater coordination to avoid isolated, unlinked activities. Khar also requested budget support in lieu of project based assistance. USAID noted the capacity building needs for GOP to adequately track and control funds.

REGIONAL COOPERATION AND TRANSIT TRADE

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¶25. (C) On the issue of transit trade with Afghanistan, Commerce Secretary Shah noted that Pakistan saw a decline in overall exports to Afghanistan in 2006-2007 and were currently seeing Afghan restrictions on Pakistani exports of edible oil and carbonated soft drinks. Shah noted that Pakistan had received a draft transit trade agreement from the Government of Afghanistan and that the GOP had also delivered their own version to Afghan officials. He noted that the transit trade agreement would be discussed at the next session of the bilateral Joint Economic Council which is not yet scheduled. Shah noted that the GOP is concerned about the delays with Afghan reimbursement to Pakistanis who transit Afghanistan and explained that the GOA is charging ten percent of the value of Pakistani goods which transit Afghanistan en route to the Central Asian nations. Shah further commented that the GOP is currently not charging Afghanistan-bound goods the full port charges and are not inspecting the trucks en route to the border.

¶26. (C) To promote regional cooperation, Shah noted that Pakistan had been fully supportive of facilitating Afghanistan's entry into the South Asian Free Trade Association (SAFTA) and paid compensation as a developed country for the least developed countries in the SAFTA pact. Shah noted that trade among the SAFTA countries is up and that the next step in SAFTA was to complete the services agreements.

Sullivan noted that increasing regional trade partners is the faster way to expand the local economy and linked the importance of expanding Pak-Afghan transit trade to greater trade within the region.

PRIVATE SECTOR COOPERATION

127. (C) Qamar noted that Pakistan needs USD 110 billion in infrastructure development in the energy, mass transport and municipal services sectors. Feasibility studies and a sovereign guarantee fund are needed as well as funding from Overseas Private Investment Corporation (OPIC) and the Export Import Bank in the form of grants. Qamar was hopeful that more public-private partnerships could be established which would be mutually beneficial to the U.S. and Pakistan and hoped to see greater private sector ties established before the next economic dialogue. A/S Sullivan noted the Senior Commercial Officer soon to be posted in Islamabad can assist those efforts and also highlighted the telemedicine project as a good example of cooperation.

CLOSING REMARKS

128. (C) In his closing remarks, Assistant Secretary Sullivan thanked Finance Minister Qamar for his leadership. He appreciated the candid discussion and underscored the importance of our economic relationship. He reemphasized the need to incorporate the FATA into the ROZ efforts and the need to restart the BIT negotiations. Finance Minister Qamar closed by saying that he felt great progress had been made during the day. He said that a matrix of actionable items would be good for follow through. He appreciated the open and frank discussions with a "good friend" on interwoven issues which he hoped lead to progress in those sectors and reemphasized that student scholarship recipients are the best ambassadors for the U.S. in Pakistan. Qamar noted that that there had been progress in moving forward on the BIT and suggested working out the differences "in coming days." Sullivan reiterated that the U.S. hoped to continue forums on Pakistan and have a broad based relationship with the new democratic government.

129. (U) This message has been cleared with A/S Sullivan's staff.

PATTERSON